School for Traders & Investors

Twenty-Seventh Lesson

More About the Theory of Pyramids

The Importance of Planning, Patience and Precautions

THEORETICALLY speaking (which is quite customary among traders who tell you about the wonderful position they once held in a certain stock, and what a small fortune they might have cleaned up *if* they had done thus and so; or what they expect to make *if* the stock they now hold will behave as it should), pyramiding is not so dangerous as some would have us believe, and sometimes opportunities with attractive probabilities are available to those who are willing to give this form of speculation serious study, and *provided* the campaign is carefully planned, and *provided* the plan is carried out with the necessary patience, and *provided* the essential precautions are taken against the unforeseen collapse of the pyramid, and *provided* suitable stocks are selected for the operation. With the above provisions, pyramiding involves the risk of small loss with the possibility of a substantial profit.

The reason why most traders do not indulge in pyramiding, or cannot make any money in it, is probably owing to their failure to select a suitable stock, that is to say, an issue that has established a reputation for wide swings when it gets under way; their failure to exercise the necessary patience in persistently carrying out their plan; and their unwillingness to take the precautions necessary to prevent disaster.

The Basic Theory

The basic theory of a pyramid is simple. For example, suppose the trader buys 100 shares of a stock at the market, and 10 shares more every point up. *If* the stock advances regularly, and never has a reaction of more than a point or two on the way up, it is apparent that the only capital that need be involved is the ten points margin on the original purchase, for the profit on the advance supplies the required margin on all subsequent purchases. If the margin is to be 20 points, the purchases after the first lot should be 5% more every point up, or 10% more every two points up. The theoretical result of such a pyramid is illustrated herewith.

For the sake of simplicity, the figures in the table do not provide for commissions, interest and invisible eighths. These are fixed charges and may be provided for as such. Again, there will be some irregularity on account of the fact that the small lots of stock will in reality be purchased at different fractions above the stop orders in the scale. However, the table illustrates the general theory. It indicates that our pyramider could make a profit of about 100% on a 9-point advance, 200% on a 14-point advance, 300% on an 18-point advance, 400% on a 22-point advance, 10 for 1 on a 40-point rise, and 16 for 1 on a 50-point rise. The theory is wonderful! Now let us investigate the "jokers."

A THEORETICAL PYRAMID

Buy 100 Shares at Market and 10% More Every Point Up

Points Rise	Total Shares	Profit Added	Total Profit	Points Margin
0	100	0	0	10
1	110	$100	$100	10
2	120	110	210	10.1
3	130	120	330	10.2
4	140	130	460	10.4
5	150	140	600	10.6
6	160	150	750	10.9
7	170	160	910	11.2
8	180	170	1,080	11.5
9	190	180	1,260	11.9
10	200	190	1,450	12.2
11	210	200	1,650	12.6
12	220	210	1,860	13.0
13	230	220	2,080	13.3
14	240	230	2,310	13.8
15	250	240	2,550	14.2
16	260	250	2,800	14.6
17	270	260	3,060	15.0
18	280	270	3,330	15.4
19	290	280	3,610	15.9
20	300	290	3,900	16.3
21	310	300	4,200	16.8
22	320	310	4,510	17.2
23	330	320	4,830	17.6
24	340	330	5,160	18.1
25	350	340	5,500	18.5
30	400	390	7,350	20.8
35	450	440	9,450	23.2
40	500	490	11,800	25.6
45	550	540	14,400	28.0
50	600	590	17,250	30.4

The Example

The first essential is a suitable stock. Backsight over the past twelve months will show that this is not impossible. For example, it will be observed that South Porto Rico Sugar has advanced from about 39 last August to 95 early in March, a total advance of about 55 points, a little beyond the range of our theoretical table. It will be noted also that after rising above 40 the last time, the stock never had a reaction of over 7 points, the second greatest reaction being about 5 points, and the others 4 points, 3 points and less. It is apparent also that with sufficient margin available to carry through a 7-point reaction, and with a stop-loss order kept 8 points below the last high for each advance, our theoretical pyramid would have worked out in practice.

Observe also that the 7-point reaction referred to began after an advance of 15 points, at which juncture our table indicates that there was an available margin of over 14 points, so that only three points more would have been required to maintain a minimum of 10 points.

Another backsight shows that Prairie Oil & Gas was under persistent accumulation last year between 155 and 158, and that it rose thereafter to 269, a total of over 110 points. In this case the joker might have been a little more disconcerting at times, for this issue indulges in wide swings. On the way up there were two reactions of 15 points, and several of 8 to 10 points. These reactions would have required either sufficient margin to carry through, or the necessary trading ability to sell out part of the line on bulges with a firm determination to repurchase on subsequent support. The kind of trading ability to which we allude has been discussed in its various phases

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will have to be reduced on this issue. The same applies to the common stock of the *Consolidated Gas Co.* which is selling to yield 8.2%, and the capital stock of the *Detroit Edison Company*.

International Telephone

Another issue, which is unusually attractive for the long-pull investment, is the capital stock of the *International Telephone and Telegraph Corporation.* This issue is selling to yield better than 8.7% and the dividend is well-secured by earnings. There is no preferred stock ahead of the issue nor any funded debt. Earnings have shown a very steady increase during the past few years. The company is a managing organization owning the stocks of companies operating telephone systems in Cuba and Porto Rico.

In conclusion, it may be said that all signs point toward the continued growth of the public utility industry, the gradual recovery of the great majority of traction companies that are now facing difficulties, and a better public understanding of the public utility situation, in general. The holders of the better grade of securities in this group apparently have little to fear as to the future prospects of their holdings.

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in these lessons, and will be referred to again in subsequent lessons. The main point in this connection is the desirability of selling some long stock on bulges and repurchasing in reactions, for the sake of marking down the average cost of the entire line carried.

An Important Requirement

One of the important characteristics that a stock should have to make it suitable for pyramiding operations is activity and a ready market at fractional variations between sales. A stock that jumps several points between sales is not usually suitable. For example, Fisher Body would not be a suitable issue for pyramiding operations with small capital, because it has a habit of dropping as much as 10 or 15 points between sales following erratic advances. The result would be that a whole string of buying orders on stop would be executed at the top price, the advantage of the rise from the last sale would be lost so far as the additional lots are concerned, and ample capital would have to be provided for serious reactions. Furthermore, it might be difficult to determine the right time to liquidate, and when the time arrived there might be no bids in the neighborhood.

Bear in mind that, after the all-important selection of *the right stock,* pyramiding operations must be supported by *sufficient capital to carry through the plan* without concern over reasonable reactions, or, *if limited capital is employed, the entire line must be protected at all times by a stop* kept within reasonable distance of the last top price, so as to prevent serious loss in case of price collapse.